STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION

Illinois Commerce Commission	)	
On Its Own Motion	)	
vs.	)	
Illinois Bell Telephone Company,	)	
Verizon North, Inc. and Verizon South, Inc.	)	Docket No. 06-0562
	)	
Investigation into the applicability of	)	
Section 2-202 of the Public Utilities Act	)	
To intrastate coin drop pay telephone	)	
Revenues		

VERIZON'S VERIFIED REPLY COMMENTS

Verizon North Inc. and Verizon South Inc. (collectively, "Verizon"), through their attorneys and pursuant to the schedule adopted by the Administrative Law Judge at the August 30, 2006 Status Hearing, hereby submit their Verified Reply Comments in the above-referenced proceeding.

Introduction

Staff endeavors unsuccessfully to support its contention that Verizon must pay Public Utility Fund ("PUF") taxes on the revenues generated from intrastate coin drop rates for pay telephone services that Verizon provides in Illinois, despite the fact that those rates are unregulated and therefore not subject to the PUF tax. Staff's arguments about treatment of payphone customer premises equipment ("CPE"), preemption of the PUF tax, taxation vs. rate regulation, and barriers to entry completely miss the point. The FCC has deregulated the *rates* that providers charge for local payphone services, and as a result, the revenue from such services does not constitute "gross revenue" under Section 3-121 of the Illinois Public Utilities Act ("PUA") because it is not collected pursuant to rates regulated under Section 9-102 of the PUA.

Further, as noted in Verizon's Verified Initial Comments ("Verizon Comments"), the additional tax sought from Verizon is negligible – less than $700 each year for 2005 and 2006, and less than $20,000 in the aggregate for the past eight years. Verizon Comments at 1. Given that this proceeding is financially unjustified, and since Staff cannot muster any credible basis on which to find Verizon liable for the payment of PUF taxes on these revenues, the Commission should resolve this investigation with a conclusive finding that PUF taxes are not appropriately collected on intrastate coin drop rates for pay telephone services provided in Illinois.

Discussion

I. The PUF Tax Does Not Apply to Intrastate Payphone Coin Drop Revenues

Staff asserts that "[t]here is no question that, as a matter of purely state law, intrastate coin-drop payphone service revenues are fully subject to the PUF tax." *See* October 17, 2006 "Initial Verified Comments of the Staff of the Illinois Commerce Commission" ("Staff Comments") at 6. Staff is incorrect. Indeed, this legal question is at the very heart of this proceeding, and both Verizon and AT&T have provided ample support for their position that the PUF tax does *not* apply to intrastate payphone coin drop revenues. *See generally* October 17, 2006 "Comments of Illinois Bell Telephone Company" ("AT&T Comments"); Verizon Comments.

Staff's comments reveal a fundamental misunderstanding of the true nature of the parties' dispute. For example, Staff asserts that Verizon and AT&T have argued that the PUF tax is a barrier to market entry or exit, and that the tax is an impermissible form of rate regulation. (Staff Comments at 6; 9; 13-15). Such arguments are nothing more than a straw man, because Verizon has not made such arguments (nor has AT&T, for that matter).

Staff fails to acknowledge, much less address, the correspondence between Verizon and the Commission that led up to the August 16, 2006 Order initiating this investigation (hereinafter, "Initiating Order"), and consequently fails to address the legal issues that are actually in controversy. Staff instead expends considerable effort on presenting a lengthy but ultimately irrelevant discourse on (1) the history of the FCC's rules and orders relating to payphones; (2) preemption theory; (3) taxation as rate regulation; and (4) tariffing requirements under 220 ILCS 5/13-501. Verizon addresses these issues below.

A. FCC Payphone Authority

Staff devotes several pages of its comments to discussing a number of authorities relating to the FCC's treatment of payphones. *See* Staff Comments at 3-4; 7-9. However, this case is not about the treatment of payphone CPE, or about encouraging the development of a competitive marketplace for payphone services, or about "fair compensation" for payphone service providers ("PSPs"). The only thing the Commission needs to know about the FCC's treatment of payphone services is that the FCC has definitively deregulated the rates that providers charge for local payphone service. *See* First Report and Order, *Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996*, CC Docket No. 96-388 (rel. September 20, 1996) at ¶¶ 51-61 ("*Payphone Order*"); *and* Order on Reconsideration, *In the Matter of Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996 et al.*, FCC 96-439/CC Docket Nos. 91-35/96-128 (rel. November 8, 1996) at ¶ 143-147 ("*Payphone Reconsideration Order*"). On appeal, the D.C. Circuit unequivocally affirmed these orders, finding that the FCC "has been given an express mandate to preempt State regulation of local coin calls." *See Illinois Public Telecommunications Ass'n v. FCC*, 117 F.3d 555, 563 (D.C. Cir. 1997). Staff freely concedes

that "[t]here is little question that the FCC determined that payphone rates should be set by the market." *See* Staff Comments at 11.

Staff thus posits the wrong question in asking whether the PUF tax constitutes improper regulation of local payphone rates. *See* Staff Comments at 9. The correct question is whether the state of Illinois may regulate intrastate coin drop rates for pay telephone services that Verizon provides in Illinois. The answer is an unequivocal "no," as Staff already concedes. Since the state may not regulate such rates, any tax that by definition applies only to rates subject to regulation (*see* 220 ILCS 5/2-202 and 3-121) cannot be imposed on the revenues derived from such services. In *Chicago SMSA Limited Partnership v. Illinois Commerce Commission*, 672 N.E.2d 37, 39 (Ill. App. 3rd Dist. 1996) ("*Chicago SMSA*"), the Illinois Appellate Court considered a similar issue, finding that:

> Because the petitioners' services do not generate any "gross revenue" as that term is defined in section 3-121, it is clear that they have no tax liability under section 2-202 of the Act. Accordingly, we hold that the petitioners are not obligated to pay public utility tax on the revenue generated by their cellular services.[1]

Although Staff attempts to distinguish this case (*see* Staff Comments at 17), Staff relies on a distinction without a difference. The fact that the ICC's authorization to regulate rates in the *Chicago SMSA* case was eliminated by ICC order – versus by FCC order in instant case – is irrelevant. The critical point of *Chicago SMSA* is that the ICC cannot assess the PUF tax on revenues collected pursuant to rates that it has no authority to regulate. *See Chicago SMSA L.P. v. Illinois Dept. of Revenue*, 715 N.E.2d 719, 724 (Ill. App. 1st Dist. 1999) ("*Illinois DOR*") (explaining that *Chicago SMSA* court "held cellular providers bore no tax liability under the act because the ICC had *excluded the cellular industry from rate regulation*") (emphasis added). If the rates are unregulated, for whatever reason, they cannot be subject to the PUF tax.

[1] *See Chicago SMSA* at 39.

Staff's insistence that states have retained the responsibility for determining whether state requirements like the PUF tax are inconsistent with the FCC's deregulatory approach is therefore ultimately irrelevant, because the question is not whether the PUF tax violates the FCC's payphone orders, but whether the PUF tax applies to local coin drop payphone revenue in the first place. There is no question that intrastate coin drop rates for pay telephone services that Verizon provides in Illinois are deregulated and therefore not under Commission jurisdiction. Consequently, the Commission cannot compel Verizon to pay the PUF tax on *unregulated* intrastate coin drop payphone revenues when the PUF tax, by definition, applies only to *regulated* revenues.

B. Preemption

Staff provides a lengthy – but ultimately unnecessary – "assay into the complicated law surrounding federal preemption" to support its contention that state regulation of payphones has not been completely preempted. *See* Staff Comments at 9. By doing so, Staff offers the Commission another red herring, since neither Verizon nor AT&T has argued otherwise.

Staff frames the crucial question incorrectly by asking "whether the statutory requirement that ILECs remit PUF tax on coin-drop rates for public payphones is preempted by the FCC's regulation in this area, as either improper rate regulation, or a[s] constituting a barrier to entry or exit." *See* Staff Comments at 9. The question is not whether the *PUF tax* is preempted as rate regulation and/or a barrier to market entry or exit, but whether *regulation of intrastate coin drop rates for pay telephone services* is preempted as rate regulation and/or a barrier to market entry or exit. If so, the ICC cannot regulate intrastate coin drop rates for pay telephone services, and those rates consequently cannot be subject to the PUF tax.

Staff's "brief assay" into preemption law fails to highlight 47 U.S.C. § 276(c), which states unequivocally that "[t]o the extent that any State requirements are inconsistent with the [Federal Communication's] Commission's regulations, the Commission's regulations on such matters shall preempt such State requirements." As detailed above, the FCC has flatly barred states from regulating intrastate coin drop rates for pay telephone services. *See Payphone Order; Payphone Reconsideration Order; Ill. Pub. Tel. Ass'n*. As even Staff admits, 47 C.F.R. § 64.1330(a) preempts any state regulations that impose market entry or exit requirements – the hallmark example being rate regulation. *See Illinois DOR* at 724 (describing "rate and market entry regulation" as "'heart of regulation'"). Staff's citation to the Commission's June 11, 2002 order in Docket 01-0614 (Staff Comments at 18) is therefore inapposite, since in that proceeding, the Commission found that the FCC had not yet spoken on the preemption question before the Commission. Here, the FCC has spoken clearly in preempting state regulation of local payphone rates, and the Commission need only comply with the FCC's explicit findings.

Because state regulation of such rates has been preempted, there can be no PUF tax due on them. This is because the "gross revenue" condition of 220 ILCS 5/2-202 cannot be met. The revenue in question does not constitute "gross revenue" as defined in 220 ILCS 5/3-121 because it was not collected pursuant to rates regulated under Section 9-102 of the Illinois Public Utilities Act ("PUA"). As noted in the Verizon Comments, Staff has never asserted that 220 ILCS 5/9-102 governs intrastate coin drop rates for pay telephone services that Verizon provides in Illinois. Rather, Staff has consistently relied on 220 ILCS 5/13-501 for the ostensible "informational tariff" requirement that it claims still applies to these services. *See* Verizon Comments at 5-6. Commission orders have similarly cited 220 ILCS 5/13-501 as the sole origin of this asserted "requirement." *See* Order, *Illinois Commerce Commission on Its Own Motion v.*

Illinois Bell Tel. Co. et al., ICC Docket 97-0630, 1997 Ill. LEXIS 856, *2 (December 3, 1997). Thus, the "trigger" for the application of the PUF tax is absent, and the Commission need not consider whether the PUF tax itself is preempted.

C. Taxation as Rate Regulation

Staff devotes several pages of its comments to arguing that state requirements relating to the collection/remittance of certain taxes and surcharges do not constitute rate regulation. *See* Staff Comments at 13-15. Once again, such authorities are irrelevant to the Commission's analysis here. Verizon has *not* argued that the PUF tax constitutes impermissible rate regulation. Verizon's point is that since the FCC has unarguably deregulated intrastate coin drop rates for pay telephone services, the ICC cannot regulate those rates. As referenced above, Staff does not dispute this. *See* Staff Comments at 11. Given that the ICC is not permitted to regulate those rates, Article 9 of the PUA does not apply, since it governs rates *regulated* by the ICC. In *Citizens Utility Board v. Illinois Commerce Commission*, 655 N.E.2d 961, 967 (Ill. App. 1st Dist. 1995) ("*CUB*"), the Illinois Appellate Court confirmed that the mandate of 220 ILCS 5/9-102 to file and keep open to public inspection a schedule of rates exists to allow the ICC to ensure that rates meet "just and reasonable" rate requirement of 220 ILCS 5/9-201(c) of the PUA. As the *CUB* court noted, "[*t]hese plenary requirements embody the Commission's plenary jurisdiction to regulate public utilities with respect to the reasonableness of rates*." *Id*. (emphasis added).

D. Tariffing

Staff closes its comments by arguing that a tariffing requirement does not constitute a barrier to market entry or exit. *See* Staff Comments at 16-18. More specifically, Staff alleges that since a "tariffing requirement constitutes a regulation tending to provide 'price disclosure,'" it is "perfectly proper state regulation." Yet, as AT&T has explained, the PUA is devoid of any

provisions providing for "informational tariffs," a point which AT&T notes was already conceded by the ICC's Office of General Counsel. *See* AT&T Comments at 4.

Staff again relies on the "competitive telecommunications service" tariffing requirements of 220 ILCS 5/13-501 to support its contention that tariffing of intrastate coin drop rates for pay telephone services provided in Illinois is required and subjects intrastate coin drop payphone revenues to the PUF tax. *See* Staff Comments at 16-17. Staff further argues that these requirements do not constitute a barrier to market entry or exit because 220 ILCS 5/13-505(a) requires only one day's notice for such filings, and does not provide for suspensions. *Id.* Staff fails to recognize the distinction between permissible regulation of competitive and noncompetitive services that are subject to some regulatory oversight and impermissible regulation of intrastate coin drop payphone rates (via an ostensible tariff requirement) that are not regulated at all by the ICC.

Staff overlooks that 220 ILCS 5/13-505(a) only applies to *increases or decreases in rates or charges* for competitive services,[2] not to the *introduction or withdrawal* of a service. To assess whether the ostensible tariffing requirement is a barrier to market entry or exit, the Commission must look to 220 ILCS 5/13-501, which sets forth the tariffing requirements for the *introduction* of a competitive service (as noted above, both Staff and the Commission have previously stated that 220 ILCS 5/13-501 governs here). Section 13-501 does not allow for one-day notice filings, but instead provides for tariff suspension, investigation and hearing. In addition, for carriers like Verizon that offer both competitive and non-competitive services, tariffs offering a new competitive service, or newly reclassifying a non-competitive service as a competitive service, cannot take effect until certain cost study filing requirements are met. *See* 220 ILCS 5/13-502(d). These are all barriers to market entry and exit.

[2] Moreover, this provision requires advance customer notification.

Moreover, as noted in Verizon's initial comments, all of this ultimately becomes irrelevant since neither Staff nor the Commission has ever asserted that 220 ILCS 5/9-102 requires Verizon to tariff its intrastate coin drop rates for pay telephone services. As detailed above, intrastate coin drop rates are not regulated under Article 9 of the PUA, and thus, do not meet the definition of "gross revenue" under 220 ILCS 5/3-121. Consequently, even if the Commission ultimately determines that providers are somehow required to file "informational tariffs" under 220 ILCS 5/13-501 for intrastate coin drop rates for pay telephone services provided in Illinois (despite the fact that the Commission is barred from regulating those rates), that would not subject payphone providers to paying PUF tax on the revenues therefrom.

Conclusion

The Commission should soundly reject Staff's efforts to extract PUF tax revenue from Verizon on the basis of an incorrect assertion that intrastate coin drop rates for pay telephone services provided in Illinois are subject to the PUF tax. The FCC has unequivocally deregulated those rates, and the Commission has never contended that they are regulated under 220 ILCS 5/9-102. Not only are Staff's bases for asserting that these revenues are subject to the PUF tax legally unsupportable, the amount Staff claims to be due from Verizon is extremely small. For all the reasons discussed herein and in Verizon's initial comments, the Commission should close this investigation with a conclusive finding that PUF taxes are not appropriately collected on such revenues.

Dated: November 14, 2006

Verizon North Inc. and Verizon South Inc.

By: _____

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VERIFICATION

Philip J. Wood Jr., being duly sworn, states on oath that he is Verizon's Vice President of Public Affairs, Policy & Communications for Illinois, and that the factual statements made in the foregoing "Verizon's Verified Reply Comments" are complete and accurate to the best of his knowledge, information and belief.

Philip J. Wood Jr.

Subscribed and sworn to before me this 9th day of November, 2006.

OFFICIAL SEAL
MARY ANDERSON
Notary Public, State of Illinois
My Commission Expires 07-14-08

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NOTICE OF FILING

Please take notice that on November 14, 2006, I caused the foregoing "Verizon's Verified Reply Comments" in the above-captioned matter to be filed electronically with the Illinois Commerce Commission via its E-Docket system.

Deborah Kuhn

CERTIFICATE OF SERVICE

I, Deborah Kuhn, certify that I caused the foregoing "Verizon's Verified Reply Comments," together with a Notice of Filing, to be served upon all parties on the attached service list on this 14th day of November, 2006, by electronic mail.

Deborah Kuhn

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